UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Dominion Cove Point LNG, LP   Docket No. RP06-417-000

ORDER ACCEPTING AND SUSPENDING TARIFF SHEETS
SUBJECT TO REFUND AND ESTABLISHING A HEARING

(Issued July 31, 2006)

1. On June 30, 2006, Dominion Cove Point LNG, LP (Cove Point) filed revised tariff sheets, listed in the Appendix, to be effective August 1, 2006, pursuant to Natural Gas Act (NGA) section 4 to generally increase the rates on its liquefied natural gas (LNG) import terminal and pipeline system. The Commission accepts and suspends the tariff sheets listed in the Appendix, to be effective January 1, 2007, subject to refund and the outcome of the hearing procedure established herein.

Background

2. Cove Point owns and operates a LNG facility in Lusby, Calvert County, Maryland, and pipeline facilities that extend approximately 88 miles from the LNG terminal to interconnections with Transcontinental Gas Pipe Line Corporation in Fairfax County, Virginia and with Columbia Gas Transmission Corporation and Dominion Transmission, Inc., in Loudon County, Virginia. Cove Point states that this is its first section 4 rate case. In 1972 the construction and operation of the LNG import terminal and the pipeline was authorized as part of a project to import LNG and transport natural gas to the U.S. markets.[1] The facilities were placed into service in 1978, but LNG services at the terminal ceased on April 10, 1980. For the next fourteen years, the facilities were not used, except for a small amount of interruptible transportation service provided through Cove Point's pipeline facilities.

3. In 1994, the Commission authorized Cove Point LNG Limited Partnership, a joint venture between subsidiaries of Columbia Gas Systems, Inc. (Columbia) and Potomac Electric Power Company (PEPCo) to reactivate a portion of the dormant onshore

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[1] *Cove Point LNG Limited Partnership*, 68 FERC ¶ 61,377 (1994), *reconsideration denied*, 69 FERC ¶ 61,292 (1994).

facilities and to construct a liquefaction unit for the purpose of storing domestic natural gas during the summer for use at peak times during the winter. Cove Point LNG Limited Partnership was authorized to provide 10-day, 5-day and 3-day firm peaking services under Rate Schedules FPS-1, FPS-2, and FPS-3, respectively, and firm and interruptible transportation services under Rate Schedules FTS and ITS. Currently, Cove Point continues to provide peaking service to four customers: Atlanta Gas Light Company, Virginia Natural Gas, Inc., Washington Gas Light Company, and Public Service Company of North Carolina.

4. In 1999, Columbia acquired PEPCo's interest in Cove Point LNG Limited Partnership and began the process of reactivating the LNG import terminal. Columbia held a successful open season resulting in contracts with three LNG import customers.[2] Cove Point LNG Limited Partnership was purchased by subsidiaries of The Williams Companies (Williams) on June 14, 2000. Cove Point was then purchased on September 5, 2002, by the current owner Consolidated Natural Gas Company, an affiliate of Dominion Resources, Inc.

5. Williams negotiated a Reactivation Settlement with the existing peaking and transportation customers and the new import customers. In September 2002, the Reactivation Settlement determined, among other things, how the costs of the existing and proposed facilities would be allocated between the peaking and import customers and established initial rates that would be charged to peaking, import, and transportation customers following reactivation of the terminal. The Reactivation Settlement was approved by the Commission in the same order in which the reactivation was certificated.[3] As a result, Cove Point provides the LTD service which consists of the receipt of LNG from ocean-going tankers, the temporary storage of LNG, and the vaporization of LNG and delivery of natural gas to points along Cove Point's existing pipeline. The service is provided throughout the year.

6. The Reactivation Settlement stated in Article IV Paragraph 2 that, "Cove Point agrees to file a NGA section 4(e) general rate case to be effective, assuming the full five (5) month statutory suspension period, no later than October 1, 2007." Cove Point states that this filing is being made pursuant to that provision. Cove Point states that it is not proposing any service or tariff changes in this proceeding.

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[2] The three current LNG import customers are: Shell NA LNG LLC, BP Energy Company, and Statoil Natural Gas LLC.

[3] *Cove Point LNG Limited Partnership,* 97 FERC ¶ 61,043*; Order Granting and Denying Rehearing in Part, Granting and Denying Clarification,* 97 FERC ¶ 61,276 (2001)*; Order Denying Rehearing and Granting and Denying Clarification,* 98 FERC ¶ 61,270 (2002).

Details of the Filing

7. Cove Point proposes to increase rates for its firm peaking service (Rate Schedules FPS-1, FPS-1, and FPS-3), LNG import service (Rate Schedules LTD-1 and LTD-2), and incremental rates. The filing reflects minor reductions in the rates for Rate Schedules FTS and ITS. The proposed rates are based on an overall cost of service of $111,960,628 which is comprised of $3,650,219 for other storage related to liquefier and related facilities, $89,310,276 for LNG terminaling and processing related to the import, process, storing and vaporizing of LNG, and $19,000,133 for interstate pipeline facilities. The proposed cost of service represents a $36,437,375 increase from the current level of $75,523,253. The filing provides for a rate base of $325,284,032, an increase from the Reactivation Settlement level of $266,183,841 which has been depreciated in the intervening years. Among other things, the rate base increase includes $56,756,141 attributable to reactivation costs not previously included in the rates when the facilities were reactivated and what Cove Point states is a $28 million rate base adjustment to restore the plant investment to reflect the original cost of the facilities.

8. Cove Point states that in the Reactivation Settlement, the parties agreed to a cap on the cost of the reactivation that could be reflected in rates prior to the filing of the instant case, but the actual prudently incurred cost necessary to restore the facility to import service was substantially in excess of the amount estimated by Williams at that time, and the amount reflected in the prior settlement rates. Cove Point also asserts that for reasons that include the high rate of usage at the terminal, increasing security costs and a tripling of plant personnel, the cost of operating and maintaining the facility has greatly increased. This increase results in a significant rate increase in the reservation charge for import shippers (Rate Schedule LTD-1) of 52 percent, from $5.797 per Dth to $8.8409 per Dth, and an increase for firm peaking service customers (Rate Schedule FPS-1) of 110 percent, from $2.9939 per Dth to $6.2776 per Dth.[4] Cove Point asserts that because of the prior settlements, the rates for these services have been held artificially low over the past three years. Cove Point states that the rates for other services have less significant changes. Cove Point states that it is continuing the incremental rates for the Cove Point East facilities and this case reflects a small increase in that rate. Cove Point is also proposing a reduction in the rates for Rate Schedules FTS and ITS services.

9. Cove Point states that the Commission deferred certain issues related to the use of gas during the start up of import activities in August 2003 to this future rate case.[5] Cove Point has determined that the fuel used for start up should be capitalized and recorded in

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[4] Rate increases are also reflected in the reservation charge for Cove Point's other services, with Rate Schedule FPS-2 increasing from $2.1794 per Dth to $4.4376 per Dth and Rate Schedule FPS-3 from $4.4014 per Dth to $4.7021 per Dth.

[5] *Dominion Cove Point LNG, LP,* 110 FERC ¶ 61,366 at P 19 (2005).

FERC Account No. 101 pursuant to 18 C.F.R. Part 201, Gas Plant Instructions 9.E and 3(21) (2006). Cove Point also states that the Commission also deferred to this filing the question of whether Cove Point should be required to refund to customers revenues received from the sale of gas not needed for start up from the commissioning cargo purchased by Cove Point. Since Cove Point purchased the LNG, a commodity, in the open market and bore the entire commodity risk, Cove Point argues that it is entitled to the full proceeds of the sale of the excess gas.

10. Cove Point is requesting a continuation of the current depreciation rate of 5% and the establishment of an asset retirement obligation for the LNG facilities and a negative salvage rate for the transmission plant.

11. Cove Point asserts that the proposed $28 million rate base adjustment is to restore plant investment to the original cost of the facilities. Cove Point explains that when PEPCo acquired an interest in the LNG facility, the Commission required a writedown (reduction) in the value of the facilities of approximately $51 million. It states that in the Reactivation Settlement the parties agreed to an “acquisition adjustment” of approximately $23 million, which effectively restored part of the rate base reduction. In this filing Cove Point states that it proposes to restore to the rate base the remainder of that reduction, $28 million, which, with the prior adjustment (a total of $51 million), will have the effect of restoring the original rate base. It states that at this time, Cove Point is not proposing to recover an acquisition adjustment to reflect the acquisition premium paid by Consolidated Natural Gas Company.

12. Cove Point is utilizing the capital structure of its parent company, Consolidated Natural Gas Company, which is approximately 57% equity and 43% debt. Cove Point is seeking a 15% return on equity which equates to an after-tax return of 11.33%, compared to the 11.20% reflected in current rates.

Notice of Filing, Interventions and Protests

13. Public notice of Cove Point’s filing was issued July 3, 2006, with interventions and protests due as provided in section 154.210 of the Commission’s regulations (18 C.F.R. § 154.210 (2005)). Pursuant to Rule 214 (18 C.F.R. § 385.214 (2005)), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties.

14. Atlanta Gas Light Company and Virginia Natural Gas, Inc. (jointly Atlanta Gas), Public Service Company of North Carolina, Inc. (PSNC), Washington Gas Light

Company (Washington Gas), FPS Shippers,[6] and Statoil Natural Gas LLC (Statoil) filed protests to the proposal. Shell NA LNG LLC and BP Energy Company (jointly Shell) filed a protest, request for hearing and suspension, and request for partial summary disposition. The protesters have raised a number of issues concerning the proposed rate increase as discussed below.

15. Concerning rate base issues, Statoil, FPS Shippers, and Shell object to various rate base items claiming that: (1) the $56,757,741 in rate base attributable to the 2003 reactivation of the terminal requires further evaluation, (2) the proposed $28 million rate base adjustment to restore the plant investment to its original cost and rectify the financial impact of earlier ownership changes is unjust, unreasonable, and inconsistent with Commission policy, (3) the projected costs associated with Cove Point's LNG Expansion Project proposed and authorized in Docket No. CP05-130-000, *et al.*,[7] should be examined, and (4) the proposal to capitalize $1,437,631 of fuel costs for the testing and start-up of the LNG terminal and proceeds from the sale of commissioning cargo requires further explanation of the relevant facts and circumstances and needs to address the Commission's concerns identified in earlier orders.[8] Shell requests the Commission to summarily deny Cove Point's request for a $28 million rate base adjustment for restoration of original plant amount.

16. Atlanta Gas, Shell, FPS Shippers, and Washington Gas object to various cost of service charges including: (1) the proposed consultants and legal fees are based on the base period plus a three-year amortization of the estimated costs which may result in an over-recovery, (2) the proposed 5% deprecation rate may not be appropriate for recently constructed facilities that will be integrated with an extensive expansion of the LNG terminal and pipeline, (3) providing justification for the inclusion of costs associated with Cove Point's proposed $3,167,009 for "asset retirement obligations" or alternatively, Cove Point's proposed negative salvage rate of 0.68%, (4) Cove Point's proposed annual charitable donation of $120,000 to the Cove Point Natural Heritage Trust should not be recategorized because the Commission has changed its policy on the recovery of charitable donations, and (5) failure to provide sufficient support for the proposed allocation of Dominion Resources Services Inc., and its affiliates for Administrative and General (A&G) costs to Cove Point.

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[6] The four FPS Shippers filed individual protests and collectively on various issues. The FPS Shippers consist of: Atlanta Gas Light Company, Public Service Company of North Carolina, Inc., Virginia Natural Gas, Inc., and Washington Gas Light Company.

[7] *Dominion Cove Point LNG, LP, 115 FERC ¶ 61,337 (2006).*

[8] *Dominion Cove Point LNG, LP*, 107 FERC 61,221 at P 23 (2005), 110 FERC ¶ 61,336 at P 19 (2005).

17. Statoil objects to a number of operation and maintenance (O&M) expense adjustments including: (1) labor adjustment of $1,173,131 for new employees without a detailed explanation or other support, (2) the proposed increase in O&M expense for security requirements imposed by the United States Coast Guard, (3) the $3,454,744 adjustment for materials and other expenses, and (4) the adjustment to Account No. 806 to remove a gas credit of $3,256,942.

18. Atlanta Gas, Washington Gas, FPS Shippers, Statoil, and Shell contend that the proposed 15% rate of return on equity is excessive, may be unjust and unreasonable, and the support for this level is highly questionable. Shell questions the propriety of Cove Point's use of the capital structure of its parent for ratemaking purposes in this proposal. Shell also objects to the proposed $18,174,583 income tax allowance since Cove Point is a limited partnership that does not pay income taxes.

19. Washington Gas, Shell, and Statoil object to various provisions of Cove Point's proposed cost allocation between Rate Schedule FPS and Rate Schedule LTD-1 service claiming that: (1) the proposed allocation of costs to the Rate Schedule FPS services may not reflect the contribution that the Rate Schedule LTD-1 service and the associated facilities make to the Rate Schedule FPS service, (2) Cove Point may have failed to allocate sufficient cost to the Rate Schedule FTS incremental service, (3) an examination of the crediting of revenues for Authorized Overrun Service is necessary to ensure that it is consistent with Commission policy which requires either the allocation of costs to a service or crediting of revenues from the service, and (4) the cost allocation methodology that requires Rate Schedule FPS shippers to pay a portion of the cost of offshore facilities that were incurred solely to serve Rate Schedule LTD-1 shippers results in an increase to the Rate Schedule FPS rates. Further, Statoil raises a concern that the proposed cost allocation and rate design may result in an unwarranted subsidization by the FPS shippers of a recently authorized Cove Point's Expansion Project which increased Cove Point's send-out capability by 800,000 Dth per day for a total peak send-out capability of 1,800,000 Dth per day.[9]

20. Washington Gas requests that the hearing be established under sections 4 and 5 of the NGA to include gas quality, interchangeability, and tariff issues associated with the reactivation of the Cove Point LNG facility, such that Washington Gas may be entitled to compensation or rate mitigation. Washington Gas also requests that the Commission require that the hearing be conducted in two phases, with the first phase considering Cove Point's current costs, cost-of-service and tariff, and with Phase II examining the impact of the recently approved Cove Point LNG Expansion proposal on non-expansion shipper's rates.

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[9] *Dominion Cove Point LNG LP,* 115 FERC ¶ 61,337 (2006).

21. On July 20, 2006, Cove Point filed an answer limited to certain issues raised by Washington Gas and Shell. While the Commission's Rules of Practice and Procedure, (18 C.F.R. § 385.213(a)(2) (2004)), generally prohibit answers to protests, the Commission will accept Cove Point's answer to provide a better understanding of the issues in this proceeding. Cove Point contends that Shell has failed to meet the standard for summary disposition and that the request should be denied. Cove Point also argues that Washington Gas should not be permitted to relitigate gas quality and interchangeability in this proceeding, and that such issues should be addressed in Cove Point's LNG Expansion proceeding. Cove Point further argues that Washington Gas' request that the hearing be bifurcated into two phases should be denied and that the costs regarding the LNG Expansion facilities are not relevant to this proceeding and must wait until the expansion facilities are placed in service.

22. Each of the protesters contends that the proposal has not been shown to be just and reasonable and is likely unjust and unreasonable. Therefore, the protesters request that the Commission suspend the filing for the full five-month suspension period and set the proposal for hearing.

Discussion

23. The rates proposed in Cove Point's section 4 filing have not been shown to be just and reasonable. The Commission finds that except for the issues discussed below, the protesters have raised a number of issues concerning Cove Point's proposed rate increase which can be more appropriately explored in a hearing established by this order. During the hearing, the parties can explore the issues raised in their protests and general rate case issues including but not limited to: (1) rate base; (2) acquisition adjustment/original cost of investment, (3) various rate base adjustments, (4) cost of service issues including O&M and A&G expenses, (5) capital structure, (6) rate of return, (7) cost allocation, (8) functionalization, and (9) rate design.

24. The Commission rejects Washington Gas' request to set gas quality and interchangeability issues for hearing in this proceeding. Washington Gas raised similar issues in its protests to Cove Point's recent LNG Expansion proceeding.[10] To address Washington Gas' concerns in that proceeding, the Commission established a procedural conference on February 22, 2006, which allowed Washington Gas, other parties to the proceeding, and Commission Staff to discuss issues relating to the quality of natural gas delivered to Washington Gas from the Cove Point LNG Terminal. At the procedural conference, Washington Gas and other parties made oral presentations addressing the cause of gas leaks on Washington Gas' system, as well as the potential effects of the

[10] *See* various Washington Gas protests to Cove Point's filings in Docket Nos. CP05-130-000 and CP05-132-000.

proposed expansion on Washington Gas' infrastructure. The Commission also received written presentations with exhibits to supplement in light of the conference presentations. In the June 16, 2006 Order approving the LNG Expansion Project, the Commission addressed these issues and found, among other things, that Cove Point delivers regasified LNG that meets the gas quality specifications of all interconnecting pipelines and that Washington Gas had not provided any basis to deny the authorizations requested for the LNG Expansion proposal.[11] Accordingly, the Commission denies the request to set gas quality and interchangeability issues for hearing in this proceeding since the Commission has addressed them on the merits in the LNG Expansion proceeding.[12]

25. The Commission also rejects Washington Gas' request that the Commission require that the hearing be conducted in two phases, with the first phase considering Cove Point's current costs, cost-of-service and tariff, and a second phase to examine the impact of the recently approved Cove Point LNG Expansion proposal on non-expansion shipper's rates. The hearing in this case is established to examine Cove Point's proposal to revise its rates based on costs and the supporting documentation during the 12 month base period and the 9 month test period ending December 31, 2006. Cove Point projects an in-service date of the third quarter of 2008 for the LNG Expansion facilities.[13] The Commission's policy for section 4 rate proceedings is that the facilities must be placed in service within the 9 month test period.[14] Thus, Washington Gas' request that the Commission establish a Phase II hearing to consider the LNG Expansion's impact on non-expansion shipper's rates concerns facilities that will be constructed and placed in service outside the test period and therefore are not subject to this proceeding. The hearing will address issues based on Cove Point's proposed rates, costs, tariff, cost-of-service, and facilities placed into service by December 31, 2006.

26. The Commission also denies Shell's request for partial summary disposition on Cove Point's request to recover $28 million as a restoration of original plant adjustment. Shell contends that the Commission should summarily dispose of this issue because: (1) there are no genuine material issues of fact relevant to making a determination, (2) there are no significant new or changed circumstances requiring a different result than that reached previously, and (3) no rational decision-maker would find in Cove Point's favor on this issue. Shell argues that if the Commission does not grant the request for

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[11] Dominion Cove Point LNG, LP, 115 FERC ¶ 61,337 at P 100 (2006) (June 16, 2006 Order).

[12] Washington Gas has requested rehearing of the June 16, 2006 Order on the gas quality and interchangeability issues, and can pursue its concerns in that proceeding.

[13] *See* Cove Point's application in CP05-132-000, transmittal letter at p. 1.

[14] *See* section 154.303(c)(1) of the Commission's regulations. 18 C.F.R. § 154.303(c)(1) (2006.

summary disposition, it should direct Cove Point to remove from its proposed rates all costs associated with the restoration of original plant investment unless and until these costs are approved by the Commission for inclusion in Cove Point's rates.

27. Since it is unclear on the face of the filing that the restoration of $28 million in original plant investment contravenes Commission policy, and the proposal raises issues of fact and ratemaking principles best resolved in hearing, the request for partial summary disposition on this issue is denied. Further, since the filing is being accepted subject to refund, we deny the request to require Cove Point to remove all cost associated with the proposed $28 million restoration of original plant investment from its proposed rates. The issue of the $28 million adjustment shall be addressed at the hearing in this proceeding.

Suspension

28. Based upon a review of the filing, the Commission finds that the proposed tariff sheets have not been shown to be just and reasonable, and may be unjust, unreasonable and unduly discriminatory or otherwise unlawful. Accordingly, the Commission shall accept the tariff sheets for filing and suspend their effectiveness for the period set forth below, subject to the conditions set forth in this order.

29. The Commission's policy regarding suspensions is that filings generally should be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust, unreasonable, or inconsistent with other statutory standards.[15] It is recognized, however, that shorter suspensions may be warranted in circumstances where suspension for the maximum period may lead to harsh and inequitable results.[16] Such circumstances do not exist here. Therefore, the Commission will accept and suspend the proposed tariff sheets listed in the Appendix, to be effective January 1, 2007, subject to refund and the outcome of the hearing established herein.

The Commission orders:

(A) The tariff sheets listed in the Appendix are accepted and suspended for five months, to be effective January 1, 2007, upon motion by Cove Point, subject to refund and the outcome of the hearing established herein.

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[15] *See Great Lakes Gas Transmission Co., 12 FERC ¶ 61,293 (1980) (five-month suspension).*

[16] *See Valley Gas Transmission, Inc.,* 12 FERC ¶ 61,197 (1980) (one-day suspension).

(B) Pursuant to the Commission's authority under the Natural Gas Act, particularly sections 4, 5, 8, and 15, and the Commission's rules and regulations, a public hearing is to be held in Docket No. RP06-417-000 concerning the lawfulness of Cove Point's filing.

(C) Shell’s request for summary disposition and Washington Gas’ request for a phased hearing and request to include gas quality and interchangeability issues in the hearing are denied as discussed in the body of the order.

(D) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose pursuant to 18 C.F.R. § 375.304 (2005), must convene a prehearing conference in this proceeding to be held within twenty (20) days after issuance of this order, in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. The prehearing conference shall be held for the purpose of establishment of a procedural schedule. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the rules of practice and procedure.

By the Commission. Commissioner Wellinghoff voted present.

(S E A L)

Magalie R. Salas,
Secretary.

Appendix

Dominion Cove Point LNG, LP
FERC Gas Tariff, Original Volume No. 1

Tariff Sheets Accepted and Suspended to be Effective January 1, 2007

Seventh Revised Sheet No. 5
Seventh Revised Sheet No. 6
Sixth Revised Sheet No. 7
Seventh Revised Sheet No. 8
Seventh Revised Sheet No. 11
Third Revised Sheet No. 12